

TESTIMONY
OF
STEVEN J. GUNN,
ATTORNEY AND PROFESSOR OF LAW (ADJUNCT),
WASHINGTON UNIVERSITY IN ST. LOUIS

BEFORE THE COMMITTEE ON INDIAN AFFAIRS
OF THE UNITED STATES SENATE

OVERSIGHT HEARING ON
STATE AND FEDERAL TAX POLICY:
BUILDING NEW MARKETS IN INDIAN COUNTRY

DECEMBER 8, 2011

Mr. Chairman, Mr. Vice Chairman, and distinguished Members of the Committee, thank you for the opportunity to appear before you today and to comment on the important issue of tribal and state taxation in Indian country. I will divide my comments into four areas: first, I will address the important role tribal taxation plays in promoting economic development in Indian country; second, I will examine the burden state and local taxation places on Indian tribes and their efforts to develop their reservation economies, and the jurisdictional conflicts such taxation engenders; third, I will share insights about the cooperative approaches some tribes and states have taken to work coordinate their respective taxes in Indian country; and finally, I will suggest some ways in which the Federal Government can help shape a tax policy for Indian country that will maximize tribal self-government and economic development.

1. Tribal Taxation Plays an Essential Role in Promoting Tribal Self-Government and Economic Development in Indian Country.

American Indian tribes are “self-governing political communities that were formed long before Europeans first settled in North America.”¹ Although they accepted the protection of the United States through treaties,² Indian tribes retain the sovereign status of “domestic dependent nations,”³ and continue to “possess[] attributes of sovereignty over both their members and their territory.”⁴

The power to tax has long been recognized as an “essential attribute of Indian sovereignty.”⁵ All three branches of the Federal Government recognize that this power is “an

¹ *Nat'l Farmers Union Ins. Co. v. Crow Tribe of Indians*, 471 U.S. 845, 851 (1985).

² *See, e.g., Treaty with the Teton*, 1815, Art. 3 (7 Stat. 125).

³ *Oklahoma Tax Comm'n v. Potawatomi*, 498 U.S. 505, 509 (1991). *Accord, Cherokee Nation v. Georgia*, 30 U.S. (5 Pet.) 1, 17 (1831).

⁴ *Merrion v. Jicarilla Apache Tribe*, 455 U.S. 130, 140 (1982), *quoting United States v. Mazurie*, 419 U.S. 544, 557 (1975). *Accord, Worcester v. Georgia*, 31 U.S. (6 Pet.) 515, 557 (1832).

⁵ *Merrion*, 455 U.S. at 139.

essential instrument of [tribal] self-government and territorial management.”⁶ The power to tax “enables a tribal government to raise revenues for its essential services.”⁷ The power derives from “the tribe’s general authority, as sovereign, to control economic activity within its jurisdiction, and to defray the cost of providing governmental services by requiring contributions from persons or enterprises engaged in economic activities within that jurisdiction.”⁸

Indian tribes have primary responsibility for meeting the basic needs of their tribal members and other individuals who reside on or who do business on their reservations. Meeting these needs requires strong, well-funded tribal governments and strong, well-funded tribal programs and services. Tribal taxation provides an essential source of revenue for the operation of tribal governments and tribal programs.

Strong tribal governments and tribal programs, in turn, fuel economic development in Indian country. Among other things, tribal legislatures, agencies, and courts provide the governmental and legal framework necessary for economic development. Tribal programs pay for the construction and maintenance of reservation roads, bridges, utilities, and other facilities that provide the physical infrastructure necessary for economic growth. Tribal education and job training programs build human capital, and tribally owned economic enterprises create jobs and revenue streams for Indian tribes. Without tribal tax revenue, these government institutions and programs could not exist.

2. State and Local Taxation in Indian Country Undermines Tribal Self-Government and Economic Development.

Indian tribes have a government-to-government relationship with the United States,⁹ but they are in no way “dependent on” or “subordinate to” the states.¹⁰ As a general rule, reservation Indians are subject only to federal and tribal law, not state law.¹¹ This is especially true in the area of taxation:

The Constitution vests the Federal Government with exclusive authority over relations with Indian tribes . . . and in recognition of the sovereignty retained by Indian tribes even after the formation of the United States, Indian tribes and individuals generally are exempt from state taxation within their own territories.¹²

In *McCulloch v. Maryland*, Chief Justice John Marshall reminded us that, “the power to tax involves the power to destroy.”¹³ The Supreme Court has long recognized that, if permitted, state taxation of Indian tribes and their members would “essentially destroy[]” tribes by depriving them

⁶ *Id.* (citing *Washington v. Confederated Tribes of Colville Reservation*, 447 U.S. 134, 153 (1980)).

⁷ *Id.* at 137.

⁸ *Id.*

⁹ *See, e.g.*, 25 U.S.C. §§ 3601(1), 3701(1); Executive Order 13175, 65 F.R. 67249 (Nov. 9, 2000); Executive Memorandum, 59 Fed. Reg. 22951 (April 29, 1994).

¹⁰ *Colville*, 447 U.S. at 154.

¹¹ *Williams v. Lee*, 358 U.S. 217 (1959).

¹² *Montana v. Blackfeet Tribe*, 471 U.S. 761, 764 (1985) (citations omitted).

¹³ 17 U.S. (4 Wheat.) 316, 431 (1819).

of their tax base.¹⁴ Thus, “[i]n the special area of state taxation of Indian tribes and tribal members,” the Supreme Court has adopted “a *per se* rule.”¹⁵ “such taxation is not permissible absent congressional consent.”¹⁶

“Taking this categorical approach, [the Supreme Court has] held unenforceable a number of state taxes whose legal incidence rested on a tribe or on tribal members inside Indian country,”¹⁷ including: income taxes,¹⁸ real property taxes,¹⁹ personal property taxes,²⁰ sales taxes,²¹ transaction taxes,²² vendor taxes,²³ use taxes,²⁴ mineral royalty taxes,²⁵ and hunting and fishing license fees.²⁶

State taxation of nonmembers in Indian country is not categorically barred. Instead, the courts apply a “flexible preemption analysis sensitive to the particular facts and legislation involved.”²⁷ According to the Court, such taxation is prohibited if it infringes on tribal self-government or if it is preempted by federal law.²⁸ State taxation of nonmembers is preempted if it interferes with or is incompatible with federal and tribal interests, as reflected in federal law, unless there are sufficient countervailing state interests to justify the assertion of state authority.

The preemption analysis requires a particularized balancing of federal, tribal, and state interests and, thus, is inherently less predictable than the *per se* rule barring all state taxation of tribes and tribal members. Applying the balancing test, the courts have struck down certain state taxes on nonmembers in Indian country and upheld others. For example, in *Ramah Navajo School Board, Inc. v. Bureau of Revenue*:

the Supreme Court found that the state could not tax the gross receipts that a non-Indian construction company received from a tribal school board for construction of a school on the reservation. The Court found the federal regulation of construction and financing of Indian schools to be ... comprehensive ... Federal statutes also reflected an “express federal policy of encouraging tribal self-sufficiency” in education. In terms of the tribal interests, the tribal school board absorbed the economic impact of the tax, which could affect its ability to provide

¹⁴ *Bryan v. Itasca County*, 426 U.S. 373, 388-89, n.14 (1976).

¹⁵ *County of Yakima v. Confederated Tribes and Bands of Yakima Nation*, 502 U.S. 251, 267 (1992) (quoting *California v. Cabazon Band of Mission Indians*, 480 U.S. 202, 215 n.17 (1987)).

¹⁶ *Mescalero Apache Tribe v. Jones*, 411 U.S. 145, 148 (1973) (quoting *McClanahan v. Arizona Tax Comm'n*, 411 U.S. 164, 171 (1973)).

¹⁷ *Oklahoma Tax Comm'n v. Chickasaw Nation*, 515 U.S. 450, 458 (1995).

¹⁸ *McClanahan*, 411 U.S. at 165-81; *Oklahoma Tax Comm'n v. Sac and Fox Nation*, 508 U.S. 114, 123-126 (1993).

¹⁹ *United States v. Rickert*, 188 U.S. 432 (1903); *The New York Indians*, 72 U.S. (5 Wall.) 761 (1866); *The Kansas Indians*, 72 U.S. (5 Wall.) 737 (1866).

²⁰ See, e.g., *Bryan*, 426 U.S. at 375; *Moe v. Confederated Salish and Kootenai Tribes of Flathead Reservation*, 425 U.S. 463, 480-81 (1976) (motor vehicle tax); *Colville*, 447 U.S. at 163 (same); *Sac and Fox*, 508 U.S. at 127-28 (same).

²¹ *Moe*, 425 U.S. at 475-481, *Potawatomi*, 498 U.S. at 507; *Dep't of Taxation and Finance of New York v. Attea & Bros.*, 512 U.S. 61, 64 (1994).

²² *County of Yakima*, 502 U.S. at 268.

²³ *Chickasaw Nation*, 515 U.S. at 459-62; *Moe*, 425 U.S. at 480-81.

²⁴ *Mescalero Apache Tribe*, 411 U.S. at 158.

²⁵ *Montana v. Blackfeet Tribe*, 471 U.S. at 764-66.

²⁶ *Menominee Tribe v. United States*, 391 U.S. 404 (1968); *Tulee v. Washington*, 315 U.S. 681 (1942).

²⁷ *Cotton Petroleum Corp. v. New Mexico*, 490 U.S. 163, 176 (1989).

²⁸ *Mescalero Apache Tribe*, 411 U.S. at 148.

education for Indian children. And the state provided no services to either the Indian school children or the non-Indian taxpayer for its activity on the reservation.²⁹

The courts have struck down other state taxes on nonmembers in Indian country, including state taxes on nonmember retailers' sales to tribes and tribal members.³⁰ However, the courts have upheld state taxes on cigarette sales to nonmembers,³¹ state severance taxes on oil and gas produced by nonmembers in Indian country,³² and a number of other "state taxes on non-Indians doing business in Indian country."³³

The Court's case-by-case approach has created uncertainty for tribes, states, and nonmembers seeking to do business in Indian country. It is difficult to determine *ex ante* whether a state will have jurisdiction to tax a given nonmember transaction in Indian country. This uncertainty makes it difficult for nonmembers to evaluate the total cost of doing business in Indian country, and it may cause some nonmembers to avoid investing in Indian country altogether.

State and local taxation of nonmembers in Indian country imposes significant economic burdens on Indian tribes, and it has the potential to undermine tribal self-government and tribal economic development. This is true for several reasons:

First and foremost, state and local taxation of nonmembers in Indian country infringes on the tribal tax base. Under existing federal law, an Indian tribe can tax nonmembers who engage in commercial dealings with the tribe or its members.³⁴ (This includes nonmember businesses that provide goods and services to the tribe or its members, and nonmember consumers who purchase goods and services from tribal businesses.) A tribe's ability to tax nonmember transactions, however, is severely impaired when state and local governments assert concurrent, or overlapping, jurisdiction to tax the same transactions. The resulting double or triple taxation is often more than tribal markets can bear, and tribes may be forced to lower their tax rates or to eschew collection of their taxes altogether on nonmember transactions. This has tremendous consequences for tribes, depriving them of millions of dollars in tax revenue on activities occurring within their jurisdictions.

Second, state and local taxation of nonmember businesses in Indian country raises the cost of the goods and services those businesses provide to Indian tribes and their members. Whenever possible, nonmember businesses, like all others, pass the financial burden of the state and local taxes on to their tribal customers in the form of higher prices. This burdens tribal members by raising the cost of the ordinary, day-to-day good and services they purchase from on-reservation, nonmember businesses. It also burdens the economic development initiatives of

²⁹ COHEN'S HANDBOOK OF FEDERAL INDIAN LAW § 8.03 (2005) (discussing *Ramah Navajo School Board, Inc. v. Bureau of Revenue*, 458 U.S. 832 (1982)) (internal citations omitted).

³⁰ *Warren Trading Post v. Ariz. State Tax Comm'n*, 380 U.S. 685 (1965); *Central Machinery Co. v. Ariz. State Tax Comm'n*, 448 U.S. 160 (1980). See also, COHEN'S HANDBOOK OF FEDERAL INDIAN LAW § 8.03 (collecting cases).

³¹ See, *Colville*, 447 U.S. at 156-157.

³² *Cotton Petroleum*, 490 U.S. at 187.

³³ COHEN'S HANDBOOK OF FEDERAL INDIAN LAW § 8.03 (collecting lower court cases).

³⁴ See, *Montana v. United States*, 450 U.S. 544, 565-566 (1981).

tribal governments and tribally owned businesses by raising the cost of construction, management, and other essential services they purchase from nonmember contractors and businesses. The impacts can be significant, especially on multi-million dollar tribal economic development projects, where the imposition of state and local taxes can add tens or hundreds of thousands of dollars to the cost of the project.

Third, if market conditions prevent nonmember businesses from passing the financial burden of state and local taxes on to their customers, the businesses may be forced to relocate off-reservation. In this way, double or triple taxation of nonmember businesses in Indian country creates a disincentive to investment in Indian country and reduces the supply of goods and services available to Indian tribes and their members.

Fourth, state and local taxation of nonmember consumers in Indian country has the effect of raising the price of goods and services sold to those consumers by tribal businesses. Imposing these taxes in addition to tribal taxes creates a competitive disadvantage for on-reservation tribal businesses in relation to their off-reservation counterparts. Nonmember consumers will have an incentive to purchase goods and services off-reservation, to avoid paying double or triple taxes.

Finally, allowing states and local governments to tax on-reservation nonmember consumers eliminates the ability of Indian tribes to attract nonmember business by marketing tribal tax rates that are lower than corresponding state and local rates. State and local governments have the power to adjust their tax rates to gain competitive advantages in relation to neighboring jurisdictions, and there appears to be no principled reason why tribes should not share in that power, especially when the value of the goods and services they offer is generated on the reservation, or when the goods and services will be consumed on the reservation.

In sum, overlapping claims of tribal, state, and local tax authority over nonmembers in Indian country hinders tribal self-government and economic development in a number of ways. It allows states and local governments to infringe on the tribal tax base; it raises the cost of goods and services sold by nonmembers to tribes and their members; it discourages nonmember investment in Indian country; it creates tax disadvantages for tribal businesses that sell goods and services to nonmembers; and it eliminates the ability of tribes to attract nonmember business by marketing lower tax rates.

3. Many Tribes and States Have Entered Cooperative Agreements to Address the Problems Created by Multiple Taxation in Indian Country.

Indian tribes and states have incentives to reach cooperative agreements regarding the collection of tribal, state, and local taxes in Indian country. As has been shown, there is uncertainty in existing federal law over the precise extent of state and local taxing authority over nonmembers in Indian country. This creates the potential for expensive and protracted litigation. Further, when state and local taxation of nonmembers is permitted, it creates the potential for double or triple taxation, which imposes hardships on nonmembers and tribes. Some have suggested that, “it is in the economic interests of states and tribes to determine the maximum tax burden that a taxpayer will bear before abandoning the taxable activity entirely.”³⁵ Finally, “[t]he

³⁵ COHEN’S HANDBOOK OF FEDERAL INDIAN LAW § 8.05 (2005).

fact that states can tax non-Indians and nonmembers in Indian country under certain circumstances, but cannot tax tribal members, also presents states and tribes with challenging record-keeping problems.”³⁶

To address these problems, tribes and states have entered cooperative agreements and enacted laws to allocate tax authority and coordinate tax collection in Indian country:

In the face of potentially overlapping or conflicting jurisdictional claims, tribal-state cooperative agreements offer both sets of governments the opportunity to coordinate the exercise of authority, share resources, reduce administrative costs, deliver services in more efficient and culturally appropriate ways, address future contingencies, and save costs of litigation. They also enable governments to craft legal arrangements reflecting the particular circumstances of individual Indian nations, rather than relying on uniform national rules. Insofar as cooperative agreements create a stable legal environment conducive to economic development, they may appeal to the common interests of tribes and states.³⁷

It has been reported that over 200 tribes have entered into compacts with states.³⁸ These compacts and related laws employ a variety of approaches, including: “exempting sales by Indian tribes or tribal merchants from state taxes, adjusting the state tax rate when a tribal tax exists so that the total tax does not exceed the state tax rate, excluding the tribal tax from the definition of sales or gross receipts taxable by the state, extending credits to taxpayers liable for state and tribal taxes, and authorizing agreements or compacts for tribal refunds from state tax revenues.”³⁹

The tax collection agreements in South Dakota provide one example of cooperative tax collection in Indian country. These agreements encompass many, but not all, of the state taxes that are imposed in Indian country, including sales taxes, cigarette taxes, motor vehicle taxes, and contractor’s taxes. Under the agreements, tribes agree to impose tribal taxes that are uniform with the state taxes. The state collects all taxes included in the agreements and remits a percentage to the tribes. The percentage remitted to the tribes is based on the percentage of their reservation populations that are Indian. (This percentage is a proxy for the percentage of on-reservation transactions that would be taxable by the tribes, under existing law.) In most cases, the great majority of taxes collected are remitted to the tribes. State collection of uniform tribal and state taxes provides predictability for taxpayers, eases the ability of the state to collect the tax, and provides competitive equality for on- and off-reservation businesses.

³⁶ *Id.*

³⁷ COHEN’S HANDBOOK OF FEDERAL INDIAN LAW § 6.05. *See also*, David H. Getches, *Negotiated Sovereignty: Intergovernmental Agreements with American Indian Tribes as Models for Expanding First Nations Self-Government*, 1 REV. CONST. STUD. 120, 121 (1993).

³⁸ COHEN’S HANDBOOK OF FEDERAL INDIAN LAW § 8.05 (citing *Tax Fairness and Tax Base Protection: Hearings on H.R. 1168 Before the United States House of Representatives Committee on Resources*, 105th Cong. (1998) (Testimony of W. Ron Allen, President, National Congress of American Indians); Arizona Legislative Council, *STARTED: State Tribal Approaches Regarding Taxation & Economic Development*, 81-105 (1995)). *See also*, Richard J. Ansson, Jr., *State Taxation of Non-Indians Whom Do Business With Indian Tribes: Why Several Recent Ninth Circuit Holdings Reemphasize the Need for Indian Tribes to Enter Into Taxation Compacts with Their Respective State*, 78 Or. L. Rev. 501, 546 (1999).

³⁹ COHEN’S HANDBOOK OF FEDERAL INDIAN LAW § 8.05 (summarizing various approaches and authorities).

Intergovernmental cooperative agreements, like those employed in South Dakota, have distinct advantages, including certainty and predictability in the imposition and collection of taxes in Indian country. While many agreements require tribes to share tax revenue with the states, they provide predictable revenue for the tribes and certainty as to collectability and enforcement of tribal taxes on nonmembers.

These agreements are not without their limitations. From the tribal perspective, revenue sharing deprives tribes of tax dollars generated by on-reservation economic activity, including the on-reservation activity of nonmembers. Preemption of state and local taxation over nonmember activity would preserve tribal tax bases in a way that many cooperative agreements do not. Further, to the extent the cooperative agreements require tribes to impose tax rates equal to the state rates, they eliminate the ability of tribes to attract nonmember business by marketing lower tax rates. Finally, tax agreements are not an option for tribes in states that are unwilling to enter into such agreements.

4. The Federal Government Can Promote Economic Development in Indian Country by Reaffirming Inherent Tribal Taxing Authority and Preempting State and Local Taxing Authority.

The Federal Government plays a critical role in shaping tribal and state tax policy in Indian country. The Government is dedicated to promoting tribal self-government and economic development in Indian country, and its tax policies for Indian country can help fulfill those objectives.

First, Congress can reaffirm the inherent authority of Indian tribes to tax all transactions in Indian country. As it stands, Indian tribes have the power to tax their own members, but their authority to tax nonmembers who reside or do business in Indian country has been diminished by the Supreme Court. Under existing case law, Indian tribes have the power to tax nonmembers who engage in commercial dealings with the tribes or their members,⁴⁰ or whose activities occur on tribal trust lands,⁴¹ but they have little inherent power to tax nonmembers outside these contexts. In *Atkinson Trading Co. v. Shirley*, the Supreme Court held that the Navajo Nation could not tax nonmember patrons of an on-reservation hotel to defray the cost of providing tribal governmental services available to those patrons, including tribal police and fire protection and tribal emergency medical services.⁴² This is contrary to principle previously articulated by the Court in *Merrion*, that Indian tribes, like other governments, have the inherent power “to defray the cost of providing governmental services by requiring contributions from persons or enterprises engaged in economic activities within that jurisdiction.”⁴³ Congress can assist tribes by reaffirming their inherent power to tax all transactions in Indian country in order to defray the cost of providing government services throughout Indian country.

Second, the Federal Government—in particular, the Justice Department—can work with Indian tribes to challenge direct state and local taxation of tribes and tribal members. Despite the

⁴⁰ *Montana*, 450 U.S. at 565-566.

⁴¹ *Merrion*, 455 U.S. at 137-140.

⁴² 532 U.S. 645, 654-655 (2001).

⁴³ *Merrion*, 455 U.S. at 137.

Supreme Court's clear, categorical bar against such taxation, tribes still face challenges from states and local governments that seek to impose their taxes on the property and activities of tribal members in Indian country. The Federal Government has intervened on behalf of tribes and their members in the past to challenge such taxes, and to seek restitution of taxes unlawfully collected,⁴⁴ and it should continue to do so. (Federal intervention is necessary to overcome state sovereign immunity and to seek restitution of past taxes.)

Third, it would be most helpful if Congress could provide, by Joint Resolution or otherwise, clarity on the scope of permissible state and local taxing authority in Indian country. In particular, Congress could reaffirm the categorical bar against state and local taxation of tribes and tribal members. In addition, Congress could establish bright line rules preempting state and local taxation of nonmembers in areas in which such taxation would undermine well-settled federal and tribal interests in promoting tribal self-determination and economic development in Indian country. Such guidance from Congress would remove uncertainty for tribes, states, and cities—and for nonmembers seeking to invest in Indian country. Preemption of state and local taxation would also preserve the tribal tax base from state and local interference. As discussed above, the existing federal preemption doctrine employs a costly, case-by-case approach and is prone to uncertainty and inconsistent results. It is based on the federal common law and is susceptible to clarification by Congress.⁴⁵

Finally, Congress could pass legislation to alleviate the burdens of multiple taxation in Indian country, in cases where state and local taxes are not preempted. For example, Congress could provide a federal tax credits for individuals forced to pay overlapping state and tribal taxes, or it could provide federal incentives for tribes and states to enter cooperative agreements. In these and other ways, the Federal Government can help shape a tax policy for Indian country that will maximize tribal self-government and economic development.

I thank you again for the opportunity to appear before you and to comment on these important issues.

⁴⁴ See, e.g., *South Dakota v. U.S. ex rel. Cheyenne River Sioux Tribe*, 105 F.3d 1552 (8th Cir.), cert. denied, 522 U.S. 981 (1997), on remand, 102 F.Supp.2d 1166 (D.S.D. 2000) (striking down state motor vehicle tax as applied to Sioux tribal members residing on their reservations).

⁴⁵ *United States v. Lara*, 541 U.S. 193 (2004).

WASHINGTON UNIVERSITY LAW

Steven Gunn Profile

Professor Gunn has extensive experience in public interest litigation and clinical practice. He is also the founder and director of the **American Indian Law Summer Program** at Washington University Law, which allows law students to spend the summer in Indian country, assisting Indian tribes in legal matters affecting their sovereignty, self-determination, and civil rights. Gunn has written articles on Indian law and on the intersection of poverty and law and economics. He was a staff attorney for the Volunteer Lawyers Project of the Boston Bar Association, where he represented low-income individuals and families in housing, public benefits, and disability discrimination cases. Before that, Gunn was a Skadden Fellow at the Indian Law Resource Center in Washington, D.C., where he represented American Indian tribes in actions to protect their land, resources, rights, and cultural heritage. As part of his Skadden Fellowship, Gunn lived and worked for a year on the Cheyenne River Indian Reservation in South Dakota, where, among other things, he represented the Cheyenne River Sioux Tribe and its members in two major federal lawsuits. Gunn received his bachelor's degree in political science and philosophy in 1992 from Stanford University and his law degree in 1995 from Yale Law School, where he received numerous awards, including the President's Award for Outstanding Leadership in the Service of the New Haven Community, the C. LaRue Munson Prize for Excellence in Work on Cases in the Clinical Program, and the Connecticut Title Attorneys' Guaranty Fund Prize for the Best Paper in the Field of Property.